

G-999/CI-93-895 ORDER DECLINING TO ADOPT TWO FEDERAL STANDARDS

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

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Chair
Commissioner
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In the Matter of an Investigation into Standards
Regarding the Encouragement of Investments
in Conservation and Energy Efficiency by Gas
Utilities under 15 USC 3203 as amended by
Section 115 of the Energy Policy Act of 1992

ISSUE DATE: May 4, 1994

DOCKET NO. G-999/CI-93-895

ORDER DECLINING TO ADOPT TWO
FEDERAL STANDARDS

PROCEDURAL HISTORY

On October 24, 1992, the federal Energy Policy Act of 1992 (the Energy Act) was signed into law. Section 115 of that Act amended the Public Utility Regulatory Policies Act of 1978 (PURPA) by adding two new energy standards to be considered by state utility regulatory commissions. 15 USC § 3203.

On November 8, 1993, the Commission issued its ORDER PROVIDING NOTICE OF COMMISSION CONSIDERATION OF ENERGY STANDARDS AND REQUESTING COMMENTS. In its Order, the Commission established the process by which it would determine whether it would adopt the two new federal energy standards. Specifically, the Commission directed interested parties to submit comments addressing a list of questions regarding the two proposed federal standards on or before December 30, 1993. The Order also provided for reply comments from the parties.

On December 30, 1993, comments were filed by the Minnesota Department of Public Service (the Department), the Residential Utilities Division of the Office of the Attorney General (RUD-OAG), a group of utilities filing jointly and consisting of Minnegasco, Northern States Power, Northern Minnesota Utilities, and Peoples Natural Gas (the Companies), the Center for Energy and Environment (CEE), and the National Alliance for Fair Competition (NAFC).

On January 20, 1994, the following parties filed reply comments: the Department, the OAG, and the Companies.

On February 25, 1994, the Department filed reply comments to NAFC.

On April 13, 1994, the Commission gave notice of its April 20, 1994 hearing on the proposed standards to all the gas utilities and all parties who have intervened in any gas matter related to conservation in the past five years or who are otherwise known to the Commission to have an interest in such issues.

On April 20, 1994, the Commission held a hearing to consider adopting the two new federal standards for gas.

FINDINGS AND CONCLUSIONS

A. Background

Section 115 of the Energy Policy Act of 1992 amended the Public Utility Regulatory Policies Act of 1978 (PURPA) by adding two new conservation and energy efficiency standards for state regulatory authorities to consider with respect to gas utilities.¹

The two new federal standards are:

1. Investment in Conservation and Demand Side Management (DSM) Standard

Under this standard, the rates charged by any State regulated gas utility must be such that the utility's prudent investments in, and expenditures for, energy conservation and load shifting programs and for other demand-side management measures which are consistent with the findings and purposes of the Energy Policy Act of 1992 **are at least as profitable** (taking into account the income lost due to reduced sales resulting from such programs) as prudent investments in, and expenditures for, the acquisition or construction of supplies and facilities. (Hereinafter, this standard will be referred to as the Conservation/DSM Standard.)

2. Gas Integrated Resource Planning (IRP) Standard

This standard requires each gas utility to employ integrated resource planning in order to provide adequate and reliable service to its gas customers at the lowest system cost. (Hereinafter, this standard will be referred to as the Gas IRP Standard.)

States are directed to consider the standards and determine, after public notice and a hearing, whether adoption of the standards is "appropriate to carry out the purposes of [PURPA]" and is otherwise consistent with applicable state law.

B. Process

Accordingly, the Commission has examined the proposed federal standards in the context of current Minnesota regulation of gas utilities, evaluated the parties' written comments, and conducted a hearing to permit the parties to further comment on this subject.

C. Summary of Findings and Conclusion

The Commission finds that the goals of PURPA that the proposed standards seek to promote are already being effectively advanced through various components of Minnesota's on-going regulatory process. Indeed, in light of the level of conservation planning in Minnesota, it appears that adoption of the proposed standard for integrated resource planning at this time would simply add a level of process (thereby causing an expenditure of time, money, and effort) without effecting any corresponding increase in the efficient use of resources.

For these reasons, the Commission will respectfully decline to adopt the proposed standards. A more detailed presentation of those reasons is more fully set forth below.

D. Analysis

¹ See 15 USC § 3203.

The three goals (or purposes) of PURPA² for retail natural gas utilities are:

- Goal 1: to promote conservation of energy supplied by gas utilities
- Goal 2: to optimize the efficient use of facilities and resources by gas utility systems and
- Goal 3: to produce equitable rates to gas consumers of natural gas.

Neither proposed standard speaks directly to the third goal (equitable rates for consumers) though each standard is understood to be implemented to achieve that goal. The proposed Conservation/DSM Standard, however, is clearly intended to promote the first PURPA goal (investment in energy conservation), and the proposed Gas IRP Standard is meant to promote the second PURPA goal (efficient resource use).

1. Assessment of the Utility of the Proposed Conservation/DSM Standard in Promoting Investment in Energy Conservation and DSM by Gas Utilities in Minnesota

Current Minnesota law provides for, and the Commission has ordered, the development of DSM incentive plans for gas utility DSM efforts.

² 15 USC § 3201.

Minn. Stat. § 216B.16, subd. 6(c)(1992) allows the Commission to order utilities to develop and submit incentive plans for Commission approval. Under this statute, the Commission may set rates to encourage utility conservation programs and to compensate utilities for earnings lost as a result of conservation programs. The same statute requires that the Commission evaluate whether the incentive plans link the incentives to the utility's performance in achieving cost-effective conservation.

In October 1991, the Commission ordered gas utilities to file financial incentive proposals (in Docket No. G-999/CI-91-188). At this time, the Commission has approved DSM financial incentive plans for all regulated gas utilities in Minnesota. The incentives are designed to replace lost margins due to CIP programs and to pay additional bonuses based on a utility's performance in achieving cost-effective savings.

The Commission finds that the operation of these incentives does everything that the Conservation/DSM Standard would do, i.e. require that a utility's prudent expenditures and investments in DSM measures be at least as profitable as prudent supply-side expenditures and investments.

In addition, DSM financial incentives as structured in Minnesota link revenues to the utility's performance in implementing cost-effective programs. DSM financial incentives in Minnesota also ensure, to the extent appropriate, that a utility is recovering lost revenues due to DSM efforts.

Since adoption of the federal standard would not enhance current procedures and may in fact prescribe a lower level of performance than the Commission currently requires, the Commission will decline to adopt the proposed standard.

2. Assessment of the Utility of the Proposed Gas IRP Standard in Optimizing the Efficient Use of Facilities and Resources by Gas Utility Systems in Minnesota

Minnesota's existing regulatory processes related to the goal sought by the proposed Gas IRP Standard include measures in the following three areas:

● Demand-Side Planning and Regulation

Pursuant to Minn. Stat. § 216B.241 (1992), gas utilities file a Conservation Improvement Plan (CIP) every two years. The CIP process involves a comprehensive review of conservation and demand-side management programs by the utilities and permits full participation by all interested persons and agencies.

In the CIP evaluation process, the local distribution companies (LDCs) use an LDC-based cost effectiveness test. An LDC considers a DSM program cost-effective when the LDC's direct cost of providing the demand side resource is lower than the LDC's avoided supply costs and avoided facility costs.

As part of their CIPs, Minnesota LDCs are required to develop a DSM financial incentive plan. Once adopted, the DSM financial incentives motivate LDCs to pursue cost-effective demand side alternatives.

In sum, the CIP planning and evaluation process helps focus the utility's attention on demand-side management and by going through the DSM process, the utility's management is encouraged to integrate demand-side thinking into the LDC's planning process.

In addition, pursuant to Minn. Stat. § 216B.163 (1992), utilities may obtain Commission authority to set flexible rates permitting natural gas to compete against certain other energy sources.

Finally, general rate case proceedings pursuant to Minn. Stat. § 216B.16 (1992) also provide a forum to address important demand side management issues: the utility's sales forecasts and rate design. For example, interruptible service rate design is a means for managing peak day demand and associated costs. A utility's rate design is reviewed, with full notice to customers and opportunity to participate, in general rate proceedings. When appropriate, rate design is also changed between rate cases, with such customer notice and hearings as the Commission deems appropriate.

● **Supply-Side Planning and Regulation**

An annual statement on the impact of the market forces on gas costs for the coming year is required by Minn. Rules, part 7825.2830. Pursuant to Minn. Rules, part. 7825.2840, notice of this report is given to all intervenors in the utility's two previous rate cases.

Pursuant to Minn. Rules, part 7825.2910, subd. 2, any time a utility changes its peak-day contract demand (entitlements) or makes other contract changes, the change must be approved by the Commission.

● **Combined Demand-Side and Supply-Side Planning and Regulation**

Minn. Rule pt. 7825.2800 requires an annual filing of each gas utility's procurement policies for selecting sources of fuel and a summary of actions taken to minimize cost, including conservation actions. Notice of this report is given to all intervenors in the utility's two previous rate cases. Minn. Rules, part 7825.2840.

This brief summary of the regulatory structure for gas utilities in Minnesota demonstrates that Minnesota already has extensive resource planning processes which meet the two purposes of integrated resource planning: a) there is adequate planning for both demand-side and supply-side activities, and b) both demand-side and supply-side activities are subject to procedures that include appropriately timed regulatory reviews and adequate public participation.

This is not to say that there is not room for improvement in the companies' performance and the regulatory measures taken to stimulate that performance. The Commission looks at DSM financial incentives as an experiment rather than as a decided matter of fact. This experiment will soon need evaluation in order to determine the real effects of DSM financial incentive plans on the public interest. Based on these evaluations, there could well be beneficial modifications made in the regulatory structure. Similarly, increased co-ordination could have many benefits, especially in the area of CIP and DSM financial incentives and vice-versa.

However, in the Commission's view these improvements do not depend on the adoption of additional formal procedures under Section 115 but will result from the Commission's continued commitment to these matters. Simply adopting the IRP standard would add nothing tangible to the Commission's quest to optimize the efficient use of the gas utilities' facilities and resources

but would immediately add an additional layer of regulatory process.

In these circumstances, the Commission finds that a formal gas IRP process would be premature. The Commission will not adopt the standard that mandates it. Nothing in this decision, of course, precludes the Commission from requiring on its own a formal IRP process for all gas utilities if, after further developments, such a requirement becomes appropriate.

E. Looking Ahead

Instead of adopting the two proposed federal standards, for the reasons explained above, the Commission will continue to expand its efforts to promote the PURPA goals. In addition to the on-going regulatory processes listed above, the Commission will

1. convene a work group beginning January 1995 to review and make recommendations to the Commission on
 - the effectiveness of demand-side management (DSM) financial incentives for gas utilities
 - how closely incentives are tied to DSM performance and how much emphasis should be place on measuring energy savings and on other performance measures
 - how incentives should be structured to allow a utility to recover lost revenues due to conservation improvement program (CIP) efforts
2. request gas utilities, the Department, the OAG and other interested parties to address the issue of the allocation of DSM program costs to customer classes in filings requesting annual CIP adjustment mechanisms and in general rate case filings, and
3. convene a second work group to develop a prototype gas purchasing incentive program, with the clarification that convening this group is not intended to discourage any company from taking the initiative to file its own a gas purchasing incentive proposal with the Commission.

ORDER

1. The Commission, after a hearing duly noticed and conducted, declines to adopt two standards proposed for state adoption in 15 USC 3203, as amended by Section 115 of the Energy Policy Act of 1992, for the reasons set forth in the text of this Order.
2. Beginning January 1995, the Commission will convene a work group to review and make recommendations to the Commission regarding the following related issues:
 - the effectiveness of demand-side management (DSM) financial incentives for gas utilities
 - how closely incentives are tied to DSM performance and how much emphasis should be placed on measuring energy savings and on other performance measures
 - how incentives should be structured to allow a utility to recover lost revenues due to conservation improvement program (CIP) efforts
3. The Commission will convene a second work group to develop a gas purchasing incentive scheme for regulated gas utilities, a prototype incentive program.
4. Notwithstanding the formation of the second work group pursuant to Ordering Paragraph 3, the Commission clarifies that the gas utilities in Minnesota need not wait upon the outcome of that second work group process and are, in fact, encouraged to take the initiative to file a gas purchasing incentive proposal with the Commission.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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